

**STATE OF CALIFORNIA
DEPARTMENT OF WATER RESOURCES**

**RESPONSE TO REQUESTS FOR RECONSIDERATION
OF AUGUST 16, 2002 DETERMINATION OF REVENUE
REQUIREMENTS**

California Code of Regulations Title 23, Section 516 (b)



October 8, 2002

Introduction and Summary of Response

On February 1, 2001, the Governor signed into law Assembly Bill 1 from the First Extraordinary Session of 2001 ("AB 1X"). In AB 1X, the Legislature responded to the inability of Pacific Gas & Electric Company ("PG&E") and Southern California Edison Company ("SCE") to buy the power needed to serve their customers.

AB 1X authorizes the California Department of Water Resources ("the Department") to purchase electric power to sell directly to the electric utilities' customers. AB 1X also authorizes the Department to enter into a Rate Agreement with the California Public Utilities Commission ("the Commission"). On March 8, 2002, the Department and the Commission entered a Rate Agreement. Both AB1X and the Rate Agreement require the Department to calculate its Revenue Requirements at least annually and submit them to the Commission. AB 1X authorizes the Department to issue bonds to recover a portion of the costs of the Department's power purchase program. AB1X also authorizes the Department to promulgate emergency regulations for purposes of implementing its power supply program.

On June 7, 2002, the Department promulgated emergency regulations for purposes of establishing a process to reach a determination of revenue requirements, as well as to examine whether such revenue requirements are just and reasonable. (*See*, California Code of Regulations, Title 23, Sections 510–517 (the "Regulations"). The Regulations were approved by the Department's Water Commission and the State's Office of Administrative Law.

Pursuant to the Regulations, the Department issued a notice of its proposed determination of revenue requirements ("Proposed Determination") on June 14, 2002 to the persons or entities that provided comments or requested notice of the prior determination of revenue requirements dated November 5, 2001, and to other persons or entities requesting notice of the Proposed Determination (collectively, "interested persons"). The notice was also made available on the Department's web site. The original deadline for submitting comments was July 5, 2002. The Department held a workshop on June 19, 2002, in Sacramento, which focused on a review of the Department's Proposed Determination. The Department sponsored a series of 4 daily conference calls (July 1 through 3, 2002 and July 8, 2002) wherein interested persons could ask questions pertaining to the Proposed Determination and receive immediate responses.

On July 3, 2002, July 10, 2002, July 26, 2002, August 9, 2002 and August 13, 2002, the Department issued notices of significant additional material to interested persons as provided by the Regulations. Concurrent with these notices of significant additional material, the comment period on the Proposed Determination and the significant additional material was extended. The Department accepted comments on the Proposed Determination and significant additional material up to and including August 14, 2002.

On August 16, 2002, the Department issued its Determination of Revenue Requirements pursuant to AB 1X and the Regulations. On August 19, 2002, the Department provided

interested parties a notice of extension to submit requests for reconsideration of the Determination of Revenue Requirements up to and including August 26, 2002. On August 19, 2002, the Department also advised and notified the Commission of its revenue requirements pursuant to Water Code Sections 80110 and 80134 and the Rate Agreement. On August 26, 2002, Southern California Edison Company ("SCE") and Pacific Gas and Electric Company ("PG&E") submitted requests for reconsideration. The Department did not receive any other requests. The Regulations state that requests for reconsideration shall be considered by the Department if timely submitted. The Department has carefully considered all the arguments presented by SCE and PG&E and is of the opinion that no grounds for reconsideration have been demonstrated.

Request of Southern California Edison Company for Reconsideration

1. The administrative record provides substantial evidentiary support for the Department 's Determination of Revenue Requirements

SCE argues that the Department should grant reconsideration of its Determination of Revenue Requirements because the Department's Determination is not supported by substantial evidence in the record.¹ SCE asserts that the record does not support the just and reasonableness of Department's long term power contracts and related costs or the Department's short term power purchases and financing costs. SCE is mistaken. There is substantial evidence in the record supporting both the Department's long term power and related costs as well as the Department's short term purchases and financing costs. For instance, SCE asserts that the record contains virtually no facts or evidence to rebut key conclusions of the December 2001 Bureau of State Audit Report on the Department's power purchase program.² This assertion ignores substantial evidence contained in the Department's administrative record which rebuts or responds to criticism contained in the State Audit report.³ The record reflects that the Department's power procurement efforts helped reduce energy market prices dramatically and prevented predicted widespread blackouts during the summer of 2001. The record also reflects that the Department has secured a significant amount of energy under contract from new power plants thereby increasing reliability of energy supply within California. SCE further argues that the Determination adds no factual evidence regarding the reasonableness of the Department's losses anticipated from sales of surplus power.⁴ SCE is correct. The Determination does not add factual evidence, it relies on factual evidence set forth in the Department's

¹ SCE Request for Reconsideration at pp. 1-3.

² SCE Request for Reconsideration at p. 2.

³ Memorandum dated October 4, 2001 from the Department of Water Resources to Thomas M. Hannigan regarding Status Report on Conclusion of DWR Power Purchase Contract Efforts. Memorandum dated December 10, 2001 from the Department of Water Resources to Mary D. Nichols regarding Department of Water Resources' Response to the State Auditor's Draft Report.

⁴ SCE Request for Reconsideration at p.3.

administrative record. SCE's argument ignores the substantial evidence in the record which supports the Department's projections of losses attributable to sales of surplus power.⁵ SCE's arguments concerning short-term purchases and financing costs likewise fail to consider the administrative record which supports these components of the Determination of Revenue Requirements. The record reflects that the Department was authorized and directed by the California Legislature to purchase the utilities' net short position.⁶ The Department's short-term power costs were legitimately incurred as part of this clear directive. SCE fails to acknowledge that the record demonstrates that the Department was able to minimize the state's exposure to more expensive short term energy purchases through its energy procurement efforts. Finally, the record contains substantial evidence supporting the Department's financing costs, including testimony presented by the Department's financial advisor.⁷

SCE also argues that the Department has failed to meet its legal burden required by California Public Utilities Code § 451.⁸ SCE argues that the Department must demonstrate by *clear and convincing evidence* that its costs are just and reasonable. SCE states that the Department has not met this evidentiary standard but provides no explanation or guidance as to why the Department's record is insufficient to support a determination of just and reasonableness. SCE is wrong as a matter of law and fact. California Public Utilities Code § 451 provides as follows:

All charges demanded or received by any public utility, or by any two or more public utilities, for any product or commodity furnished or to be furnished or any service rendered or to be rendered shall be just and reasonable. Every unjust or unreasonable charge demanded or received for such product or commodity or service is unlawful.

Every public utility shall furnish and maintain such adequate, efficient, just, and reasonable service, instrumentalities, equipment, and facilities, including telephone facilities, as defined in Section 54.1 of the Civil Code, as are necessary to promote the safety, health, comfort, and convenience of its patrons, employees, and the public.

⁵ Testimony of James McMahon and Craig McDonald dated June 6, 2002 presented in California Public Utilities Commission Rulemaking 02-10-011 – Implementation of the Suspension of Direct Access Pursuant to Assembly Bill 1X and Decision 01-09-060. Proposed Determination of Revenue Requirements dated June 14, 2002. CPUC Monthly Reporting of Cost and Revenue Summary dated July 1, 2002.

⁶ Water Code § 80012. "The department shall do those things necessary and authorized under Chapter 2 (commencing with Section 80100) to make power available directly or indirectly to electric consumers in California."

⁷ Prepared Testimony of Douglas Montague dated July 9, 2002; Supplemental Testimony of Douglas Montague dated August 13, 2002; Interim Energy Financing Bridge Loan Transcript. Report of Independent Accountants prepared by Price Waterhouse Coopers dated December 14, 2001. Declaration of Douglas Montague dated August 9, 2002.

⁸ SCE Request for Reconsideration at pp. 3-4.

All rules made by a public utility affecting or pertaining to its charges or service to the public shall be just and reasonable .

California Public Utilities Code § 451 does not establish a burden of proof. Instead SCE relies on Commission Decision 00-02-046 which describes the Commission's procedures applicable to examining a utility's revenue requirement pursuant to § 451. SCE identifies the correct burden of proof applicable to utilities in Commission proceedings addressing the just and reasonableness of utility revenue requirements. In this case, however, the Department has established procedures to examine its own revenue requirements in order to determine whether they such are just and reasonable consistent with AB1X and § 451. This is not a proceeding before the Commission.⁹ The Department's procedures require that the record must demonstrate by substantial evidence that the Determination of Revenue Requirements is just and reasonable.¹⁰ This evidentiary standard is consistent with the standard of judicial review applicable to Commission Decisions, which requires that findings be supported by substantial evidence in light of the whole record.¹¹

SCE also asserts that Water Code § 80100 establishes additional criteria to determine if a cost is just and reasonable. The Department agrees and has expressly incorporated these criteria in its Regulations. The Department has relied on its administrative record to determine if its power procurement and related costs were incurred consistent with these criteria.

2. The Department's Regulations are valid and were implemented appropriately

The remainder of SCE's request for reconsideration addresses the validity of the Department' Regulations and the Department's implementation of those Regulations under the Administrative Procedures Act.¹² The Regulations were promulgated in accordance with law and establish a process for the Department to follow in its Determination of Revenue Requirements and in a just and reasonable determination. No criticisms were made concerning the Regulations during the opportunity for public comment before the California Water Commission or the Office of Administrative Law.

The Department followed the procedures set forth in the Administrative Procedures Act for promulgating regulations in connection with the power supply program. The regulations (1) establish procedures for public participation in the Department's

⁹ Water Code § 80110.

¹⁰ Regulations § 517.

¹¹ California Public Utilities Code § 1757 (a)(4).

¹² SCE Request for Reconsideration at pp. 4-10.

determination of its revenue requirements for the power supply program and (2) interpret and make specific the "just and reasonable" standards. The Regulations were submitted to the California Water Commission¹³ for its review and approval and then submitted to the Office of Administrative Law for review.¹⁴ Ten days prior to the meeting, the Department gave notice of the Water Commission meeting to consider the proposed regulations. Notice was given both to the traditional list used for Water Commission meetings as well as the service list in the Commission's Rate Stabilization docket (Application 00-11-038 et al.). The purpose of the expanded notice was to assure that interested persons would receive notice of the proposed regulations.

The Water Commission held a public meeting on June 7, 2002, at which Commission members heard a staff briefing on the regulations, asked questions about the Regulations, solicited public comment, and ultimately approved the Regulations. After approval of the Regulations by the Water Commission, the Office of Administrative Law reviewed the proposed regulations to assure they met the statutory standards in Government Code Section 11349.1: necessity, authority, clarity, consistency, reference, and nonduplication. The Office of Administrative Law approved the Regulations and filed them with the Secretary of State, at which time they became effective. Upon filing with the Secretary of State, the Regulations are presumptively valid.¹⁵ The Department made its recent Determination of Revenue Requirements in accordance with the Regulations.

SCE's criticisms of the Department's implementation of the Regulations do not support reconsideration of the Determination of Revenue Requirements. The Department provided notice and a reasonable opportunity for interested persons to comment throughout the process. The Department initially provided 21 days for parties to comment on the Proposed Determination. Thereafter, the Department weighed the time provided for interested persons to comment on additional significant material against the amount of additional significant material noticed as well as the need to submit a Determination of Revenue Requirements to the Commission consistent with AB1X and the Rate Agreement. In each case the Department provided a reasonable opportunity for interested persons to comment. Attached hereto as Appendix A is timeline of the

¹³ Water Code Section 160 requires that the Department's regulations be approved by the California Water Commission. The Water Commission is a public body independent of the Department of Water Resources whose administrative functions have traditionally been provided by the Department. The Water Commission has nine members appointed by the Governor and approved by the Senate. Meetings of the Commission are public and subject to the Bagley-Keene Open Meetings Act (California Government Code § 11120).

¹⁴ It is the Department's position that the determination of a revenue requirement and the determination that a revenue requirement is "just and reasonable" are not subject to the APA. Even though the Department contends these regulations are exempt from the Administrative Procedure Act, the Department chose to adopt them as emergency regulations using Administrative Procedure Act procedures in order to comply with a Superior Court Order in *PG&E v. California Department of Water Resources, et al.*, and, while appealing it, to provide the public with an opportunity for public participation in the development of the regulations through the use of familiar procedures and to reduce the possibility of additional litigation. (See *20th Century Ins. Co. v. Garamendi* (1994) 8 Cal. 4th 216, 248 and 270-271.) Accordingly, the Department submitted the emergency regulations to the Office of Administrative Law for review pursuant to Government Code § 11349.6.

¹⁵ Government Code Section § 11343.6.

Department's administrative process and a description of materials noticed for review and comment.

Request of Pacific Gas and Electric Company for Reconsideration

PG&E's Request for Reconsideration complains that the procedures used by the Department to reach its Determination of Revenue Requirements are insufficient. PG&E argues that the absence of evidentiary hearings and an opportunity to cross-examine witnesses undermines the Department's Determination. However, there is no requirement under AB1X or California Public Utilities Code § 451 that the Department hold evidentiary hearings in connection with a just and reasonableness review.¹⁶ PG&E argues that the Department failed to provide a reasonable opportunity to comment on its Proposed Determination. To the contrary, the Department has provided interested persons with sufficient opportunity to comment on both its Proposed Determination and the additional significant material relied upon in support of its Determination of Revenue Requirements. PG&E also asserts that the Department has ignored litigation initiated by the State of California before the Federal Regulatory Commission ("FERC") against generators concerning whether the Department's long term contracts contain terms and conditions that are neither just nor reasonable. PG&E is mistaken. The Department has not ignored this litigation. The Department has already incorporated results from renegotiations of long term contracts into its Determination of Revenue Requirements and intends to incorporate any other changes to its long term contracts that may result from litigation before FERC.

PG&E's request for reconsideration also enumerates eight reasons that the Department should grant Reconsideration of its Determination of Revenue Requirements. The Department is not persuaded by PG&E's arguments and has addressed each below.

1. The Department has applied the appropriate criteria for determining whether the costs and decisions underlying its revenue requirements are just and reasonable

PG&E argues that the Department's Determination of Revenue Requirements violates the standard for determining whether the Department's costs and decisions are "just and reasonable" under the Water Code and Public Utilities Code Section 451.¹⁷ Essentially, PG&E argues that any just and reasonable review conducted by the Department must apply both the statutory directives of AB1X as well as the just and reasonable standard of Section 451.

AB1X provides as to the power purchase contracts in Section 80100:

¹⁶ *Wood v. Public Utilities Commission* (1971) 4 Cal. 3d 288, 292-293.

¹⁷ PG&E Request for Reconsideration at pp. 3-9

Upon those terms, limitations, and conditions as it prescribes, the department may contract with any person, local publicly owned electric utility, or other entity for the purchase of power *on such terms and for such periods as the department determines and at such prices the department deems appropriate* taking into account all of the following....

- (1) The intent of the program is to achieve an overall portfolio of contracts for energy resulting in reliable service at the lowest possible price per kilowatt hour.
- (2) The need to have contract supplies to fit each aspect of the overall energy load profile.
- (3) The desire to secure as much low-cost power as possible under contract.
- (4) The duration and timing of contracts made available from sellers.
- (5) The length of time sellers of electricity offer to sell such electricity.
- (6) The desire to secure as much firm and nonfirm renewable energy as possible.¹⁸

(Emphasis Added)

Section 80010 thereby specifically provides a standard for the terms, periods and prices for the Department to utilize in entering into power purchase agreements, i.e., a “determines and deems appropriate” standard, combined with specific factors to consider.

Other sections of AB1X also provide general guidance and direction for the power supply program. The statute’s statement of purpose, the list of factors for the power purchase contracts, and the full-cost-recovery financing system provide the framework for determining if the revenue requirement is “just and reasonable.”

The overall purpose of the emergency legislation was described by AB1X as follows:

The furnishing of reliable reasonably priced electric service is essential for the safety, health, and well-being of the people of California. A number of factors have resulted in a rapid, unforeseen shortage of electric power and energy available in the state and rapid and substantial increases in wholesale energy costs and retail energy rates, with statewide impact, to such a degree that it constitutes an immediate peril to the health, safety, life and property of the inhabitants of the state, and the public interest, welfare, convenience and necessity require the state to participate in markets for the purchase and sale of power and energy.¹⁹

¹⁸ California Water Code Section 80100.

¹⁹ California Water Code Section 80000.

Specific provisions, particularly those relating to the financing of the program, are pertinent to this analysis. Fundamentally, all obligations authorized by AB1X (including both power purchase obligations and bond obligations) are payable solely from the Electric Power Fund.²⁰ The Electric Power Fund consists of revenues received from the program's activities, proceeds from the Interim Loan, proceeds from future bond sales, and an advance from the General Fund which must be repaid.²¹ Neither the full faith and credit nor the taxing power of the State is pledged for any payment under any obligation arising from the Department's activities pursuant to the power supply program.²²

The power supply program is operated in the public interest, and each cost is incurred for the public benefit, not for private benefit. As a public agency, the Department may not realize a profit from the power supply program. Accordingly, AB1X requires all revenues to be deposited in the Electric Power Fund, limits the use of amounts in the Electric Power Fund to the purposes of AB1X and prohibits sale of power at costs greater than the its aggregate costs under AB1X.²³ The power supply program is a cost-recovery program: it operates on a not-for-profit basis and must recover all costs of the program in its revenue requirements. The Department has no authority – either in AB1X or elsewhere – for recovering costs for the power supply program from any source except the Electric Power Fund.

Indeed, considering that emergency Division 27 was enacted to deal with and the Legislative findings and declarations in Section 80000, there was a need for immediate action by the Department. Any formal just and reasonable determination necessarily had to follow this action, since validly incurred power purchase costs were mandated before any just and reasonable determination proceeding was possible.²⁴ The overriding import of the statute is to permit the Department to operate a power supply program, pay the costs thereof and repay the General Fund for advances made to the Electric Power Fund.

PG&E's request for reconsideration ignores the fact that the utilities' creditworthiness was the crisis issue that resulted in AB1X, and there is no indication in the legislative history of AB1X or in the Department's administrative record that the Legislature intended that the Department and its creditors run the risk that the Department would not recover its costs. If the Department were to interpret AB1X to authorize disallowance of costs through a post-hoc review process, it would have frustrated the program from the start – power producers would not have had faith in the Department's ability to pay them and would not have contracted to sell power to the Department under such circumstances. With the

²⁰ California Water Code Section 80200(d).

²¹ California Water Code Section 80200(a), (b).

²² California Water Code Section 80200(d).

²³ California Water Cost Sections 80200(a); 80200(b); 80116.

²⁴ An alternate view would hold that the just and reasonable determination was made informally at the same time the costs were incurred.

price of power needed to meet the residual net short annually approximating ten percent of the budget of the State of California, no reasonable person could believe that the financial backing of the State alone would be adequate to supply the necessary assurances to power producers. The Legislature clearly intended all valid costs of the Department's power purchase costs to be recovered and recognized that Section 451 required an exception to its literal application and therefore provided it.

This approach is not inconsistent with the Section 451 review conducted by the Commission. The Commission is the agency which holds the authority to determine whether an IOU's proposed rates and charges are just and reasonable under Section 451 of the Public Utilities Code.²⁵ A common theme of Commission decisions is that in order to be "just and reasonable" the costs or expenses must be those a "prudent person" would incur to provide the commodity or service being provided by the IOU, given the circumstances and facts that were known or should have been known at the time the cost or expenses to provide the commodity or service were incurred. Although AB1X expressly cites Section 451, it is clear that the agency traditionally charged with interpreting that section – i.e., the Commission -- is not given the authority to do so in the power supply program. AB1X unequivocally places such authority in the Department.

In conducting its just and reasonable review, the Department has applied both the statutory criteria of AB1X and the just and reasonable standard contained in Section 451. The Regulations governing the Department's Determination of Revenue Requirements expressly provide as follows:

(a) To protect ratepayer interests, the record of the determination must demonstrate by substantial evidence that the revenue requirement is just and reasonable, considering the circumstances existing or projected to exist at the respective times of the department's decisions concerning whether to incur the costs comprising such revenue requirement, and the factors which under the Act are relevant to such determination and such decisions, including but not limited to the following:

(1) The development and operation of the program as provided in the Act is in all respects for the welfare and the benefit of the people of the state, to protect the public peace, health, and safety, and constitutes an essential governmental purpose;

(2) The department must do those things necessary and authorized under chapter 2 of the Act to make power available directly or indirectly to electric consumers in California; provided that except as otherwise stated,

²⁵ It bears emphasis that the Department acknowledges the Commission's role in interpreting Public Utilities Code Section 451, and has not, in making the just and reasonable determination, sought to influence the Commission's interpretation or application of Section 451.

nothing in the Act authorizes the department to take ownership of the transmission, generation, or distribution assets of any electrical corporation in the State of California;

(3) Upon those terms, limitations, and conditions as it prescribes, the department may contract with any person, local publicly owned electric utility, or other entity for the purchase of power on such terms and for such periods as the department determines and at such prices the department deems appropriate taking into account all of the factors listed in section 80100 of the Water Code;

(4) The department may sell any power acquired by the department pursuant to the Act to retail end use customers, and to local publicly owned electric utilities, at not more than the department's acquisition costs, including transmission, scheduling, and other related costs, plus other costs as provided in section 80200 of the Water Code;

(5) The department must, at least annually, and more frequently as required, establish and revise revenue requirements sufficient, together with any moneys on deposit in the Electric Power Fund, to provide for all of the amounts listed in section 80134(a) of the Water Code, including but not limited to the repayment to the General Fund of appropriations made to the Electric Power Fund for purposes of the Act; and

(6) Obligations of the department authorized by the Act shall be payable solely from the Electric Power Fund.²⁶

This regulation is faithful to both Section 451 and the legislative intent expressed in AB1X. In reaching its Determination of Revenue Requirements, the Department utilized the standard established in the regulation (focused on considerations found in the Act) and the traditional Section 451 "prudent person" approach. This two-pronged approach assured a comprehensive review, provided increased information to the public, and permitted Department management to evaluate the power supply program.

Like SCE, PG&E asserts that the Department must grant reconsideration to apply a clear and convincing burden of proof to the Department's review of the Proposed Determination.²⁷ PG&E also asserts that the Department's Determination is not based on substantial evidence in the record. As discussed above, the Department established procedures to examine its own revenue requirements and to determine whether its

²⁶ Regulations § 517.

²⁷ PG&E Request for Reconsideration at pp. 6-7.

revenue requirements are just and reasonable consistent with AB1X and § 451. The Department's procedures require that the record demonstrate by substantial evidence that the revenue requirements are just and reasonable.²⁸ This evidentiary standard is consistent with the standard of judicial review applicable to Commission Decisions, which requires that findings be supported by substantial evidence in light of the whole record.²⁹

2. The Department's Determination of Revenue Requirements is supported by substantial evidence in the record

PG&E asserts that the Department's Determination of Revenue Requirements is not supported by substantial evidence in the record.³⁰ PG&E identifies four sets of costs for which it believes substantial evidence does not exist in the record. In particular, PG&E asserts that just and reasonableness of costs associated with long term power purchase contracts are not supported by substantial evidence in the record. For example, PG&E argues that the record provides virtually no facts or evidence to rebut the December 2001, Bureau of State Audit Report concerning the Department's power purchase program. PG&E is misinformed. The record does contain evidence which responds to and rebuts the Bureau of State Audit Report.³¹ PG&E further argues that the record provides no evidence regarding the Department's projections for the losses resulting from surplus sales of power. Like SCE, PG&E has failed to review the record for the evidence which supports the Department's projections. To develop its projected revenues from the sale of surplus power for 2003, the Department relied on actual revenues generated from the sale of surplus power during 2001 and 2002, which data is contained within the simulation model supporting the Determination of Revenue Requirements. There is substantial evidence in the record to support the Department's Determination that its Revenue Requirements to recover these costs is just and reasonable.³² PG&E asserts the Department does not have the legal authority to pass on losses resulting from the sales of surplus power.³³ PG&E's argument misreads AB1X. As the Commission has explained:

[AB1X] merely provides that DWR may sell surplus power and limits the maximum amount it may charge for that power. However, it does not prevent DWR from recovering losses associated with such sales from end-use customers. Furthermore, it is unlikely that the Legislature expected DWR to purchase the exact amount of power required at all times. Since electricity cannot be stored, DWR would necessarily sell any surplus. Indeed, such action would serve to minimize the losses that

²⁸ Regulations § 517.

²⁹ California Public Utilities Code § 1757 (a)(4).

³⁰ PG&E Request for Reconsideration at pp. 9-5.

³¹ See, fn 2, supra.

³² See, fn 5, supra

³³ PG&E Request for Reconsideration at p. 11, citing Water Code § 80116.

would be incurred from surplus energy. Consequently, it is not unreasonable to assume that such losses from sale of surplus power should be included in DWR's revenue requirement.³⁴

Under AB1X, the costs of the program must be recovered in the Department's revenue requirement. Revenues generated from sales of surplus power are used to offset the acquisition costs incurred by the Department to supply California with energy. Losses attributable to sales of surplus power are reasonably included in the revenue requirements.

PG&E also points to the lack of evidence to support the Department's short term energy purchases.³⁵ PG&E complains that there is no quantitative or analytical support to determine that the Department's short term energy purchases during the first half of 2001 are just and reasonable. The Determination of Revenue Requirements by the Department requires application of the standard set forth in its Regulations. There is substantial evidence in the record that supports that these costs were incurred consistent with the mandate of AB1X and as a result of prudent decision making exercised by the Department's management.³⁶ Likewise the record contains substantial evidence supporting the reasonableness of the Department's administrative and general costs and its financing costs.³⁷ PG&E's argument that the Department has relied on additional materials not within the record to reach its Determination is wrong.

3. The Department has relied on its administrative record in accordance with the Regulations

PG&E argues that the Department's Determination of Revenue Requirements relies on significant additional material that is not part of the administrative record and that the Department has not made available for review and comment.³⁸ PG&E characterizes the State of California's ongoing efforts to structure and issue bonds as a process that relies on significant amounts of financial data, information, documents, analyses and materials which are not part of the record of this proceeding. The record contains significant summaries of Bond Related Costs as that term is defined by the Rate Agreement. Based on this information, the Department reached a Determination of Revenue Requirements. PG&E also argues that the Department may not rely on information to reach its Determination which the Department disclosed to interested persons during the course of public telephone conference calls. The Department has not relied on any extra-record

³⁴ CPUC Decision 02-03-062, *Order Modifying Decision 02-02-052 and Decision 02-03-063 and denying rehearing of these decisions, as modified* (March 21, 2002), 2000 Cal. PUC LEXIS 1103, *citing* Water Code § 80116.

³⁵ Short term energy purchases include those purchases made for less than 90 days' duration, including energy purchases in the day-ahead and hour ahead markets.

³⁶ Declaration of Peter S. Garris dated August 9, 2002. Declaration of Ronald O. Nichols dated August 8, 2002 and Declaration of Susan Lee dated August 9, 2002.

³⁷ Declaration of James E. Olson dated August 9, 2002.

³⁸ PG&E Request for Reconsideration at pp. 15-18.

information in reaching its Determination. The public telephone conference calls were expressly scheduled to assist interested persons understand the Department's Proposed Determination and answer questions concerning information contained within the administrative record so that interested persons could formulate comments on the Proposed Determination.

4. The Department's reliance on additional significant material is appropriate for purposes of reaching its Determination.

PG&E maintains that Department's Determination of Revenue Requirements improperly relies on documents and materials that were not disclosed before July 3, 9 and 26, 2002 and August 9, and 13, 2002.³⁹ PG&E's argument ignores the fundamental process established by the Department's Regulations to establish a Revenue Requirement. On June 14, 2002, the Department issued its Proposed Determination and made materials supporting the Proposed Determinations available for review. These materials supporting the Proposed Determination consisted of a comprehensive record of materials, including a market simulation and financial model. The Proposed Determination itself consisted of approximately 50 pages and provided sufficient information so that interested persons received fair notice of the Department's Proposed Determination. Further, interested persons had access to the materials upon which the Department was relying. The administrative record provided the source documents for this action. The Department held a public workshop as well as public telephone conference calls to provide interested persons with further assistance in understanding the Proposed Determination and the materials in the administrative record.

During the course of the Department's proceeding additional significant material was identified upon which the Department intended to rely to reach a Determination of Revenue Requirements. This information was properly noticed pursuant to the Regulations, and interested persons were provided an opportunity to comment. Consistent with its Regulations, the Department provided reasonable opportunity for parties to review and comment on the additional significant material. In the case of materials released on August 13, 2002, these materials were limited to approximately eight pages of supplemental information regarding the Department's Bond Related Costs. In this case, the Department considered that it was necessary to provide interested persons with an opportunity to comment while at the same time reaching a Determination of Revenue Requirements within a timeframe that would permit the Commission to establish Power Charges pursuant to the Rate Agreement. Notably, PG&E has failed to provide any argument in its request for reconsideration that would cause the Department to reconsider relying on this information.

³⁹ PG&E Request for Reconsideration at pp. 18-21.

5. The Department's Regulations were promulgated in accordance with AB1X and the California Administrative Procedure's Act

PG&E alleges that the Department's Regulations governing its Determination of Revenue Requirements have been promulgated in violation of the California Administrative Procedure Act's requirements for promulgation of regulations.⁴⁰ As discussed above in response to SCE's Request for Reconsideration, the Regulations were promulgated in accordance with law and established the process that the Department utilized to reach a Determination of Revenue Requirements and a just and reasonable determination. PG&E's allegation is without merit.

6. The Department's Determination of Revenue Requirements is not inconsistent with the litigation efforts of the State of California

PG&E asserts that the Department's Determination of Revenue Requirements is contrary to assertions made by the Governor and State of California that certain of DWR's long-term power contracts and related costs are not just and reasonable.⁴¹ The Department has expressly recognized the State of California's efforts to pursue refunds, lower prices or changes to the terms and conditions of long term power purchase contracts through litigation before FERC.⁴² To the extent the Department's long-term contracts are modified by order or through renegotiation, these modifications will be incorporated into future Determinations. However, the Department must consider whether its Revenue Requirements are just and reasonable within the legal framework established by AB1X and Public Utilities Code Section 451. The litigation before FERC, which was initiated by the Commission and the California Electricity Oversight Board, alleges that under Section 206 of the Federal Power Act, the Department's long-term contracts are not just and reasonable due to the market power that suppliers exercised at the time the Department was placed in the position of obtaining contracts to assure reliable service and reduce the cost of energy. This contention is not inconsistent with the Department's Determination that its Revenue Requirements are just and reasonable. Entering into the long term contracts was a just and reasonable action compared to the alternative of continuing to purchase large volumes of energy at excessive prices. The dramatic reduction in spot market prices, and the reduction in total costs, inclusive of the costs of the contracts themselves, as compared to (a) prices that were experienced prior to action by the Department⁴³ and (b) prices and energy shortages projected by other knowledgeable

⁴⁰ PG&E Request for Reconsideration at pp. 21-22.

⁴¹ PG&E Request for Reconsideration at pp. 11-12, 23-24

⁴² Determination of Revenue Requirements at p. 66, n.1.

⁴³ Memorandum dated December 10, 2001 from the Department of Water Resources to Mary D. Nichols regarding Department of Water Resources' Response to the State Auditor's Draft Report. Declaration of Ronald O. Nichols dated August 8, 2002.

persons and organizations in the market⁴⁴ absent actions taken by the Department, are evidence that the actions by the Department were appropriate. In the context of AB1X, the actions taken by the Department are reasonable. To maintain a reliable power supply, achieve lower prices in the market and halt the unsupportable continued drain on the State General Fund, the Department reasonably determined to move expeditiously to convert spot market purchases in an explosive market into longer-term bilateral contracts.⁴⁵

7. The Department's Determination of Revenue Requirements is a reasoned decision and not an abuse of discretion

PG&E argues that the Department's Determination of Revenue Requirements is arbitrary, capricious and an abuse of DWR's discretion under the Water Code, the Public Utilities Code, the California Administrative Procedure Act and the California Code of Civil Procedure.⁴⁶ PG&E provides no substantive argument to support its assertions. As discussed above and in the Determination itself, the Department's Determination of Revenue Requirements was a reasoned decision based on substantial evidence in the record developed pursuant to the Department's Regulations.

8. The Department's Determination of Revenue Requirements is made consistent with the directives of AB1X

PG&E raises a legal challenge to the Department's Determination of Revenue Requirements on the grounds that the Determination was made under an unlawful delegation of authority to the Department that violates the separation of powers and due process requirements of the California Constitution. PG&E is requesting that DWR reconsider its Determination because the statute authorizing the Department's power purchase program is unconstitutional. The Department disagrees.

In support of its request for reconsideration, PG&E relies on *State Board of Dry Cleaners v. Thrifty-D-Lux Cleaners, Inc.*⁴⁷ to argue that the Legislature has unconstitutionally delegated its power to the Department to make a just and reasonable determination of its revenue requirements and therefore chargeable to PG&E's ratepayers. PG&E's reliance on *Thrifty-D-Lux* is misplaced for at least two reasons.

⁴⁴ Energy Market Report published by Economic Insight, Inc. Platts Daily Price Reports. Declaration of Ronald O. Nichols dated August 8, 2002.

⁴⁵ Memorandum dated December 10, 2001 from the Department of Water Resources to Mary D. Nichols regarding Department of Water Resources' Response to the State Auditor's Draft Report.

⁴⁶ PG&E Request for Reconsideration at p. 24.

⁴⁷ (1953) 40 Cal. 2d 436.

First, *Thrifty-D-Lux* involved price regulations developed by an administrative board made up of interested members of the dry cleaning industry. The Court determined that the Legislature had conferred legislative authority to the board to regulate the business of their competitors. AB1X confers no such authority. The Department is not a competitor of PG&E. To the contrary, the fundamental reason for the Department's power supply program is to procure power on behalf of investor owned utilities because the utilities were unable to procure adequate supply to serve their electric loads. PG&E's argument that the Department's Determination of Revenue Requirements threatens PG&E's ability to recover money from its own retail electric customers is also wrong. The Department in no way competes for a portion of rates from PG&E's retail customers. The Department's Revenue Requirements are recovered separately from utility rates. Pursuant to the Rate Agreement, it is the Commission and not the Department which determines rates and allocates the Department's Revenue Requirements among retail customers, and Section 6.1(b) of the Rate Agreement expressly provides that the Department's charges "shall be established by the Commission without regard to the levels or amounts of any particular rate or charges authorized by the Commission to be charged by any Electrical Corporation for electrical power sold by such Electrical Corporation".

Second, in *Thrifty-D-Lux*, the Court ruled that the Legislature had not provided an ascertainable standard to guide the administrative body. As discussed above, AB1X contains specific statutory directives to guide the Department's power supply program and to reach a Determination of Revenue Requirements. Moreover, as an administrative agency, the Department is prohibited from refusing to enforce a statute on the alleged ground that it is unconstitutional.⁴⁸

For the reasons set forth above, the Requests for Reconsideration submitted by SCE and PG&E do not state sufficient grounds for reconsideration and are therefore denied.

⁴⁸ California Constitution Article 3, Section 3.5.

APPENDIX A

Date	Description of Material Noticed or Action Taken	Period for Comment
June 14, 2002	Proposed Determination, Administrative Record	July 5, 2002 ^A
June 19, 2002	Public workshop on Proposed Determination in Sacramento, California	
July 1, 2002	Public telephone conference workshop on Proposed Determination	
July 2, 2002	Public telephone conference workshop on Proposed Determination	
July 3, 2002	Public telephone conference workshop on Proposed Determination	
July 3, 2002	Notice of Additional Significant Material <ul style="list-style-type: none"> • Model update to include revised direct access loads in utility service territories. 	July 15, 2002
July 8, 2002	Public telephone conference workshop on Proposed Determination	
July 9, 2002	Notice of Additional Significant Material <ul style="list-style-type: none"> • Testimony concerning Bond Related Costs • Public documents in support of Determination 	July 16, 2002

^A The Department extended this initial comment period and continued to receive comments on its Proposed Determination and all noticed additional significant material up to and including August 14, 2002.

July 26, 2002	<p>Notice of Additional Significant Material</p> <ul style="list-style-type: none"> • Transcript of Interim Loan obtained by the Department to avoid further draws on the State's General Fund • Computer model relied upon to evaluate long term contract proposals and net short energy needs 	August 5, 2002
August 9, 2002	<p>Notice of Additional Significant Material</p> <ul style="list-style-type: none"> • Updated Financial Model • ProSym Output • Just and Reasonable Declarations • Information Supporting the Just and Reasonable Declarations • Summary of Changes to ProSym 	August 14, 2002
August 13, 2002 ^B	<p>Notice of Additional Significant Material</p> <ul style="list-style-type: none"> • Supplemental Testimony concerning Bond Related Costs 	August 14, 2002
August 16, 2002	<p>Determination of Revenue Requirements Issued</p>	

^B The Supplemental Testimony was prepared to reflect Bond Related Costs resulting from modification to the structure of the State's upcoming issuance of bonds. The Department had previously provided SCE and PG&E with reasonable opportunities to request information concerning the Department's proposed bond structure.